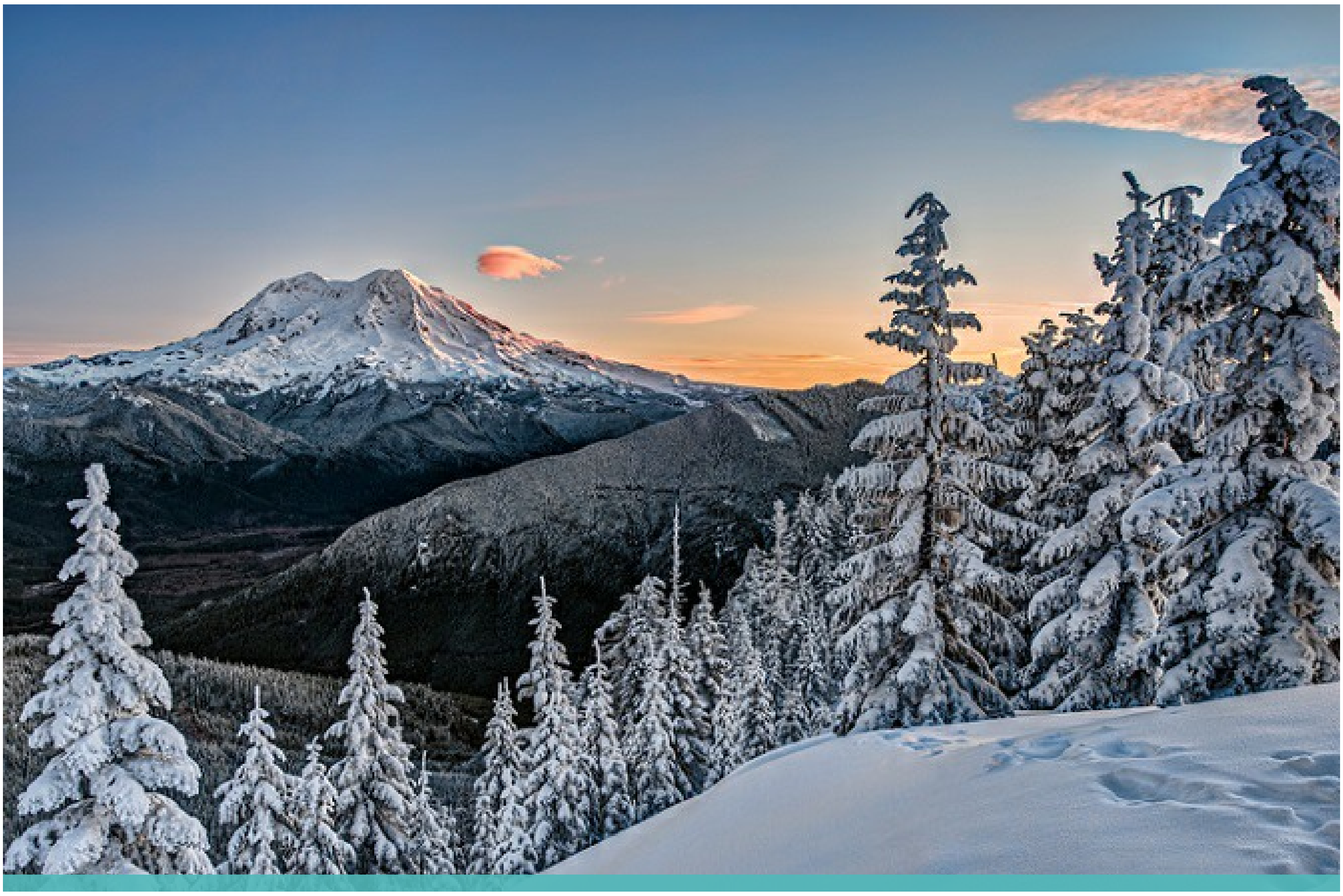
Washington: Plans for new revenues could generate $4.4 billion in the next biennium



David M. Kall | Thursday, January 12, 2017

In December, Gov. Jay Inslee put forth his budget proposal for the biennium period 2017-19. In the document containing the highlights, he characterized his plan as a “bold vision for Washington’s future,” stressing his focus on fully funding basic education. He promised to resolve the state’s “school-funding dilemma once and for all,” and also to make additional investments to support students and educators in the classroom. Pointing out that K-12 funding takes up the largest portion of the budget but is still inadequate, the governor opined that satisfaction of a court order to fully fund K-12 education by 2017 would cost billions of dollars in new state support.

Additionally, the governor promised to rebuild the state’s mental health system, and provide vital resources to strengthen the safety net for those with mental health and chemical dependency issues.

Gov. Inslee stated that he is not willing to reduce other state programs to meet the school funding obligations, because this would require “devastating cuts” not only to social services, but also to higher education, health care, or public safety. This, he declared, does “not reflect the values and priorities of most Washingtonians.” Instead, he proposes fixing the state’s “antiquated tax system” so that it generates revenues sufficient to provide the services that citizens expect. Overall, the governor anticipates generating nearly $4.4 billion in net new revenue for the 2017–19 biennium.

To this end, the budget proposal focuses on new funding, budget reserves, which are projected to be close to $2 billion at the end of the current biennium, and modest cuts, rather than increases in property or sales taxes. There are four key components of the new funding plan, as follows. Especially noteworthy is that the last component, a carbon tax, was put to voters in November and rejected.

1. **Closing five outdated tax exemptions** that are no longer fulfilling their original purpose. The proposed exemptions that Gov. Inslee wants to close are as follows:

Exemption	Amount of revenue to be generated, in millions
Limit the trade-in exclusion to $10,000 for motor vehicles, recreational vehicles, boats and other items. The current unlimited deduction primarily benefits high-income earners, who have the state’s lowest tax burdens.	$90.8

Convert the current nonresident sales tax exemption to a refund program for the 6.5 percent state portion of the sales tax. This exemption is outdated, having been created in the 1960s, and provides a tax advantage to out-of-state residents over Washington residents.	$49.2
Repeal the sales tax exemption on bottled water. Those with a medical prescription for bottled water and those without access to potable water will receive a refund.	$57.1
Repeal the extracted fuel exemption, except on wood byproducts, known as hog fuel. The biggest beneficiaries of this exemption are oil refineries that did not exist when this exemption was created. Other industries pay tax when they use materials they manufacture themselves.	$51.8
Limit the real estate excise tax (REET) exemption on foreclosure sales, such that REET would be imposed if a lender or creditor receives property through a foreclosure proceeding or by enforcing a judgment; property is sold at a foreclosure or sheriff's auction; or property is transferred by order of the court in a foreclosure or a judgment enforcement proceeding. This is a matter of fairness; the average homeowner pays REET, and so should a bank.	$59.4

2. **Imposing a new capital gains tax** on the sale of stocks, bonds and other assets to increase the share of state taxes paid by a tiny fraction of the wealthiest taxpayers, estimated to raise $821 million in fiscal year 2019. Salary and wage income is not capital gains so would not be taxed under this scheme. The tax rate would be 7.9 percent on capital gains earnings above $25,000 for individuals and $50,000 for joint filers, starting in the second year of the biennium. As one of only nine states that do not currently tax capital gains, the 7.9 percent rate would put Washington's below both Oregon's and California's, which are 9.9 percent, and 13.3 percent, respectively. The plan also contains provisions to mitigate volatility by accruing revenues exceeding $900 million in any year in a school investment reserve fund.
3. **Increasing the business and occupation (B&O) tax rate** from 1.5 to 2.5 percent, which is projected to generate $2.3 billion in the next biennium. The B&O tax is applied to a broad range of personal and professional services, such as those provided by accountants, architects, attorneys, consultants and real estate agents. The B&O tax exemption for small businesses would be more than doubled, to $100,000, to avoid a tax increase on the state's smallest business owners. The plan also increases the small business tax credit to $125 per month for all businesses. These measures would benefit approximately 38,000 firms.
4. **Enacting a new tax on carbon pollution** associated with the production and consumption of fossil fuels, expected to produce $1.9 billion in the next biennium. About half of that revenue would be directed toward K-12 education. The rest would be either reinvested in clean energy and transportation projects to lower consumer fuel bills and reduce greenhouse gas emissions; directed toward water infrastructure and forest health projects; or used to offset taxes to businesses and low-income households that are especially vulnerable to increased energy costs.

When we last addressed this carbon tax, in early December, we noted that although voters had rejected its imposition, 58 to 41 percent, proponents would pursue it through legislation first, in 2017, and failing that, another ballot measure in 2018.

In commenting on the governor's "tax trifecta," of new revenue generators, the Tax Foundation asserted that "[a]ll three proposals face an uphill battle, if history is any guide." Despite the fact that the groups absorbing the largest impact are businesses and high net worth individuals, "the overall effect… would be to discourage in-state investment and growth." Moreover, because much of the new revenue does not come until 2019, the total size of the increase is "significantly larger" than the stated amount of $4.4 billion.

Gov. Inslee is not likely to be deterred by these kinds of predictions. He believes his proposal is "rooted in fairness for working families…[it] calls for a balanced mix of revenue changes that will address the state's immediate needs and create a sustainable revenue system better designed to keep pace with needs as our economy grows."

David M. Kall

Team member bio